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SUBCOMMITTEE ON TAXATION

MONEYS, SOLVENT CREDITS
AND
INDUSTRIAL FACILITIES TAXATION

MONTANA LEGISLATIVE COUNCIL
900 BROADWAY, SUITE 100
HELENA, MONTANA 59601

December 1974

Montana Legislative Council
State Capitol
Helena, Montana 59601

Membership
Subcommittee on Taxation

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SENATE RESOLUTION NO. 61

A RESOLUTION OF THE SENATE OF THE STATE OF MONTANA REQUESTING THE COMMITTEE ON PRIORITIES TO ASSIGN THE APPROPRIATE STANDING COMMITTEES TO STUDY THE TAXATION OF MONEYS AND SOLVENT CREDITS.

WHEREAS, the state is constitutionally obliged to appraise, assess and equalize the valuation of all property within the state, and

WHEREAS, the fairness and collectability of a tax on moneys and solvent credits have been questioned.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE OF THE STATE OF MONTANA:

That the Committee on Priorities is requested to assign the appropriate standing committees to study, with the assistance of the Department of Revenue, methods of taxation of moneys and solvent credits presently classified as class 5 (a) property under section 84-301; the committees shall report to the first session of the Forty-fourth Legislature and shall consider existing and alternative taxing methods and procedures appropriate for Montana, and shall further consider the constitutional, economic, and fiscal implications of exempting moneys and solvent credits from taxation or of alternatives to the present method of taxing moneys and solvent credits.

SENATE RESOLUTION NO. 76

A RESOLUTION OF THE SENATE OF THE STATE OF MONTANA REQUESTING THE COMMITTEE ON PRIORITIES TO ASSIGN THE APPROPRIATE STANDING COMMITTEES TO STUDY THE TAXATION OF NEW INDUSTRIAL FACILITIES.

WHEREAS, many taxing jurisdictions seek to attract investment in new industrial plants by providing special reductions in the tax burden on such plants for several years, and

WHEREAS, the state of Montana has a tax incentive for new industrial investment in Class Seven of section 84-301, R.C.M. 1947, but the incentive is limited to certain types of industry and excludes other types which ought to be encouraged to locate in Montana, and

WHEREAS, the legislature should review the application of the Class Seven tax incentive in the context of a policy to strengthen and diversify the economy of Montana by attracting investment in sectors such as light, non-polluting manufacturing.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE OF THE STATE OF MONTANA:

That the Committee on Priorities is requested to assign the appropriate standing committees to study, with the assistance of the Department of Revenue, the taxation of new industrial facilities, reviewing the administration and application of Class Seven, section 84-301, to determine its effectiveness as an incentive for desirable economic growth, and to report the resulting findings and recommendations to the first session of the Forty-fourth Legislature.

INTRODUCTION

Senate Resolution 61 of the second session of the Forty-third Legislature resolved that a committee be appointed to study, with the assistance of the Department of Revenue, the method of taxing property presently classified as class 5 (a) moneys and credits in section 84-301, R.C.M. 1947. It was further resolved that alternative measures be suggested if the present system of taxation proved inadequate.

Senate Resolution 76 requested that a study reviewing the taxation of new industrial facilities be undertaken to determine whether class seven of section 84-301 can be revised to give a tax incentive to light, nonpolluting industries and thereby encourage desirable economic growth.

The Committee on Priorities assigned these tasks to the Subcommittee on Taxation, which met three times and arrived at no firm recommendations. However, the subcommittee did request that the Legislative Council staff conduct studies and draft legislation pursuant to the two Senate resolutions. Following the second meeting, the staff member assigned to the subcommittee conducting the research and drafting of bills pertaining to moneys and solvent credits resigned. No bill was prepared and no further study undertaken. The subcommittee held a third and last meeting on September 30, 1974. This report summarizes the committee's deliberations and sets forth some of the alternatives considered by the committee.

PROPERTY TAX ON MONEY AND SOLVENT CREDITS

Present System

The term "moneys and credits" and the term "solvent credits" are apparently considered synonymous. The present system of taxing moneys and credits must be considered a failure in at least one vital sense: the tax is widely evaded with consequent deleterious effects on the revenues received. As will be noted below, there is estimated to be at least three billion dollars worth of this property in existence in Montana. In 1973 only seventy-five million dollars worth was reported. (Assuming a mill levy of 200 mills, the difference between what was collected and what should have been collected is forty-one million dollars!) It is evaded for two principal reasons. Because moneys and credits are intangible properties they are (1) difficult to locate and (2) highly mobile. In physical form they are pieces of paper or magnetic imprints on computer tapes that are representative of

value. Thus, while they do have a physical existence, they are easily concealable, or even when no deliberate intent to conceal them exists, they are still difficult to locate, given the small size of the assessor's staff and the very heavy workload assessors already carry. In addition, in our present economic structure, moneys and credits are transferable beyond the jurisdiction of the assessor merely by a quick phone call, or a check and a ten-cent stamp.

The kinds of property which fall into the classification of moneys and credits are currency, deposits in financial institutions, stocks, bonds, and certain other kinds of evidences of debts, including accounts receivable. The Department of Revenue, as a rule of thumb, holds that any intangible property which is highly liquid, that is, quickly convertible into cash, falls into the category of moneys and credits. The dollar amount of this kind of property which actually exists in Montana cannot be accurately determined because the necessary statistical information does not exist. The only component which can be reported with accuracy is deposits in banks and savings and loan associations. In December 1973 the figure was well in excess of two billion dollars in demand and time deposits. The value of stocks, bonds, accounts receivable, etc., can only be guessed at, but probably is in excess of one billion dollars.

The statutory framework which authorized this tax has been largely unchanged since the enactment of the property classification statute in 1919. Certain of the definitions in the statute are even older, going back to 1891 as part of the first revenue act passed after statehood.

Section 84-301 states in relevant part:

Classification of property for taxation. For the purpose of taxation the taxable property in the state shall be classified as follows: ...

Class Five. (a) All moneys and credits, secured or unsecured, including all state, county, school district and other municipal bonds, warrants and securities, without any deduction or offset; provided, however, that the terms "moneys and credits" as herein used shall not embrace the moneyed capital employed in the banking business by any banking corporation or individual in this state.

Section 84-302 provides that the property in class five is to be taxed at "7% of its true and full value".

From the standpoint of statutory construction, significant questions arise as to what types of property fall within the classification of moneys and credits. There are no Montana statutes or cases defining "money" for purposes of this statute. As noted earlier, in the administration of the tax, "money" is regarded as currency and bank deposits. The administrative

definition thus goes somewhat beyond the customary economic definition which includes currency and demand deposits, but not time deposits. However, the distinction is insignificant insofar as the present tax system is concerned because if time deposits are not money, they certainly are credits.

The question of what is a "credit" is considerably more complex, in part because of ambiguity in the statutes. Section 84-301, already quoted, provides some help by specifically including evidences of debt of state and local governmental entities. Thus bonds, etc., whose income is exempt from the income tax are subject to the property tax. On the other hand, the statute excludes the moneyed capital used in the banking business. (This property is taxed under the provisions of section 84-308.) Three other sections of the code, 84-101, 84-202, and 84-303, also amplify the meaning of "credits". In relevant portion they state:

84-101. Definition of terms. Whenever the terms mentioned in this section are employed in dealing with the subject of taxation, they are employed in the sense hereafter affixed to them.

First--the term "property" includes moneys, credits, bonds, stocks, franchises, and all other matters and things real, personal, and mixed, capable of private ownership; but this must not be construed so as to authorize the taxation of the stocks of any company or corporation when the property of such company or corporation represented by such stocks is within the state and has been taxed....

Sixth--the term "credit" means those solvent debts, secured or unsecured, owing to a person....

84-202. Exemptions from taxation.... Evidences of debt secured by mortgages of record upon real or personal property in the state of Montana...is exempt from taxation....

84-303. Moneys and credits defined for taxation purposes. That moneys and credits are hereby defined for the purpose of taxation as all moneys not constituting moneyed capital as hereinafter defined, and all credits secured and unsecured, including all state, county, school district and other municipal bonds, warrants and securities, without any deduction or offset; provided, however, that credits, as herein defined, shall not embrace credits constituting moneyed capital as hereinafter defined or evidence of debt secured by mortgage of record upon real or personal property in the state of Montana.

It will be noted that nothing is contributed by the definition in Section 84-303 that was not a part of sections already quoted.

Beginning with the language of section 84-101, the question arises as to the taxability of stock. In the first definition, "credits" and "stock" are separately mentioned as kinds of property subject to taxation. Additionally, it appears that stock which is representative of property in Montana already taxed is not to be construed as property, and thus not to be taxed. In the sixth definition, "credits" is given the meaning of solvent debts owing to a person. This would seem to preclude stock as it is generally regarded to represent ownership as opposed to debt. However, the Montana Supreme Court has held that stock, at least of corporations whose property is not taxed in Montana, is within the meaning of "credits" for the purpose of this tax.

Section 84-202, providing for exemptions, presents some further guidance and creates additional ambiguities. For purposes of this tax, "credits" does not include a solvent debt owing to a person that is represented by a mortgage of record on real or personal property. In 1963 when the Uniform Commercial Code was enacted, those sections of the code dealing with personal property mortgages (Chapter 3 of Title 52) were revised in such a way as to replace the personal property mortgage with security interests. The references in sections 84-202 and 84-303 to personal property mortgages were not changed to reflect the U.C.C. This is a matter of some significance to the business community which tends to be more responsive to this tax than private individuals because many accounts receivable are for property in which a security interest has been perfected.

Finally, the language in the statutes, particularly the sixth definition in section 84-101 suggests that some kinds of property not currently considered as class five (a) property perhaps ought to be. Some examples are vested rights in pension plans, cash values in insurance policies, unrecorded contracts for deed and the like.

Approaches of Other States

The ad valorem property taxation of moneys and credits is not seriously attempted by very many states. In fact, only one, West Virginia, has in recent years received a significant amount of revenue from the taxation of intangible property. (However, in 1973 its legislature exempted currency and bank deposits from the intangible tax.) The statutes of twenty-two states expressly exempt intangible property from taxation. Only seventeen states do attempt to tax money and credits -- with poor success except for the one state noted above. The remaining states do not expressly forbid the taxation of intangibles, particularly moneys and credits, but neither do they attempt seriously to tax those kinds of property.

The tax on moneys and credits fares even worse among Montana's neighboring states and the West in general than it does in the rest of the country. Only South Dakota attempts to tax

these forms of intangibles. The approach utilized by South Dakota is substantially different than that used by Montana. Currency, non-interest-bearing debts, non-interest-bearing bank deposits (which includes, of course, the large amounts in demand deposits) and all bonds issued by governmental entities are exempt from the tax. Further, the first \$15,000 of taxable property is exempt. The rate that is applied on any amount over \$15,000 is 4 mills on 60% of the true value. In 1973 money and credits of the value of \$194,511,000 were reported. Four hundred sixty-seven thousand dollars of revenue was paid the state. As noted earlier, Montana reported revenue of approximately \$1,000,000 on reported property of \$75,000,000 value.

ALTERNATIVES

The subcommittee considered the following alternatives, after being informed that the list of alternatives was by no means exhaustive but represented what appear to be the major approaches utilized by the various states. The alternatives are, within limits, subject to variation and combination with each other.

The factors dealt with are: impact on revenues; costs of administration; impact on nontax aspects of the economy; and the nature of the legislative input required to make the approach workable.

The alternatives may be broken down into four major types, which include: repeal of the tax; variations on the present ad valorem tax; a new tax on certain kinds of bank deposits, and an income tax on the earnings of moneys and credits.

Repeal

The effect on the revenues of this course of action would be relatively mild, since at the present time less than one-half of one percent of total revenues received by state and local governments is derived from this tax. Since administrative costs on the tax now are minimal, neither would there be significant savings resulting from its repeal. There are few if any economic effects arising because of this tax. Its repeal would not change that situation.

(a) Total Repeal

To achieve this result all that would be required is to amend class five (a) property out of 84-301 and place that kind of property within the exemptions in 84-202.

(b) Exempt Everyone But Utilities

One of the concerns with total repeal was voiced by the utilities. They are presently subject to unitary assessment by the Department of Revenue, which assesses their value by means of a formula which does not directly consider moneys and credits. Three factors, which are weighted unevenly, are utilized: the capitalized earnings factor, the replacement value factor, and the equity-debt factor. The Department apportions to each county its share of the taxable value of the utility. Although moneys and credits do not directly figure into the valuation process, the utilities are permitted to subtract the value of moneys and credits from the total value of the business certified to the county, thus effectively lowering the taxes of the utility.

Variations on Ad Valorem Taxation

Some statements apply generally to any alternatives in this section. First, there will be high costs of administration if the tax is to be made effective. There are ways of locating much of this kind of property, through examination of income tax returns, state and federal, bank deposit records and the like, but they all are expensive in terms of man-hours per transaction. Secondly, the non-tax economic impact would very likely be profound. If moneys and credits are successfully taxed here, but are untaxed across the border, the smart money (which frequently is synonymous with big money) will move across the border, thus affecting the liquidity of banks and their abilities to make loans resulting in generally harmful economic effects.

The amount of revenue that would be received is problematical --certainly more than now, but possibly not worth the cost.

According to the Department of Revenue, it would be necessary to pass legislation enabling them to get at the records of individual bank depositors in order to begin to effectively administer this tax.

Some other variations of the ad valorem tax are as follows: (1) strict enforcement of the present system, (2) repeal of the tax except as it pertains to utilities, (3) utilization of exemptions either in dollar amount in the manner used by South Dakota, or exemption of individuals while maintaining the tax for business.

Tax on Deposits

This alternative eliminates many of the difficulties of administration that presently exist. If it is used as a

substitute for the current tax it also eliminates all forms of moneys and credits, except deposits, from the tax base. In practice the tax would work as follows: Each bank and savings and loan association in the state would be required to report the amount of money in demand and time deposits on the assessment date. The assessor would then levy a tax separate from the general levy (Rhode Island uses a rate of 4 mills) on the value of the deposits. The banks could either absorb the tax themselves or pass it on to their depositors.

As noted above, administrative costs would be slight. The banks already are required to keep this kind of information and to make it public at specified times. An occasional audit to keep everyone honest would appear to be the major expense. Revenues would increase considerably. (If a four-mill tax is assessed on two billion dollars of deposits the revenue is eight million dollars.) There would be a slight decline in revenues from bank taxes, in that the undivided profits would be diminished to the extent of the deposits tax. However, the tax loss from undivided profits is far smaller than the gain from a deposits tax.

The economic impact is more difficult to assess, but should be minimal for the following reasons: The life's blood of banks is customer deposits. Any serious diminution of the amount of money in those deposits severely damages the bank's ability to loan money, and thus adversely affects its profit picture. By having a tax rate that is low enough to insure that banks can operate profitably, the banks, against whom the tax is levied, would not encourage their customers to move their deposits out of state because to do so would harm the bank. On the other hand one of the effects of this tax could be to hold down interest rates paid to depositors. To that extent it might encourage the flight of funds to investments which give a higher rate of return.

The legislative action necessary in this case would consist of exempting moneys and credits from the property tax and enacting laws permitting the taxation of deposits in banks and savings and loan associations.

Surtax on Investment Income

This alternative would tax the income from intangible property in addition to the tax imposed by the general income tax. There would be some additional costs of administration associated with this type of tax as it would require some revision of income tax administration. Revenues would increase somewhat depending upon the rate of taxation -- assuming a tax rate of 4% on the gross income from investments of 1.5 billion dollars in value which earn a 6% rate of return, the revenue would be \$3,600,000.

The following discussion which appeared in Vol. 4:310 of the Connecticut Law Review was written by Lester B. Snyder.

"A viable solution would be to have a state imposed and administered gross income tax on intangible investment income of individuals and fiduciaries, or if a general state income tax system is either adopted or already exists, by taxing this type of investment income at a higher rate than other income. Taxing "gross" instead of "net" income (i.e., investment income after deductions for investment expenses) is more appropriate because (1) this tax is a substitute for an ad valorem property tax, which does not generally permit deductions for expenses, mortgages, and the like (particularly as to the type of individually owned and fiduciary investment income we should concentrate our efforts on), and (2) it mitigates the use of tax-avoidance schemes, manipulation and timing of expenses attributable to investments.

Gross investment income could be broadly defined so as to encompass a wide variety of items, including life insurance and annuity proceeds, and virtually all "unearned" income derived from capital investments. However, in order to formulate the least expensive and most feasible administrative plan, which at the same time reaches the bulk of intangible property, it is more appropriate to limit the tax base to the major items -- dividends, interest, and net capital gain income, as defined for federal income tax purposes, without the benefit of the fifty percent long-term capital gain deduction or other preferential treatment of capital gains under federal law. It is somewhat debatable whether an intangibles tax ought to include capital gains from real estate and tangible personal property. In theory they should be excluded, but a case could be made for taxing all capital gains on the ground that the property tax on income-producing property may be effectively shifted to another person or entity, thereby leaving the capital gains tax as the only property tax borne by the owner of the property. Capital gains on non-income-producing property should probably be excluded from the intangible property tax. For those taxpayers who hold "growth stocks", and other property which appreciates in value, and who hold such property without disposing of it prior to death (thereby avoiding a gains tax during their lifetimes), the unrealized and untaxed appreciation of this property at death should be included in the investment income tax base. There is also some question as to whether rental income ought to be included in the tax base, since real property and tangible personalty (from which this income is derived) are already taxed under the local property tax. However, since rental income represents only about 3% of all investment income property and since the tax on rental property is most often shifted to the tenant it would be more feasible to include rental income in the investment income tax. While an investment income tax is not a new principle, none of the states are currently realizing the full potential from this type of tax. Although nine states impose a limited tax on

income from intangibles, the revenue yield is relatively low because of the exemption of large amounts of corporate stock and bonds, savings accounts, and other investments, or because of inordinately low tax rates.

The revenue collected by the states could either be returned to the local governments (as a grant in lieu of taxing intangibles under the local property tax), or retained in whole or part by the states and expended for local government functions, such as public school education. The precise formula adopted in determining how to share this state investment tax revenue with the localities could take many forms. For example, it might be based on population, income attributable to each town, need, educational costs, or a combination of all these factors. If state grants to municipalities were based on investment income attributable to residents of each city or town, those localities with the most wealth would fare better than urban centers with large numbers of low-income families, which is somewhat the present pattern under current property tax laws. These disparities should be resolved by a fair method of allocation based on a combination of factors. As will be more specifically described below, a tax rate of eight to ten per cent on investment income could provide somewhere between \$8-10 billion a year in additional property tax revenues in the United States, or about twenty-five to thirty per cent of present property tax collections. Aside from aiding the fiscal plight of state and local governments and real estate owners, this proposal could serve as a solution to the present crises raised by the recent California Supreme Court decision, [Serrano v. Priest, 487 P2d 1241 (1971)] virtually requiring a method of financing local public school education based on a uniform state imposed and administered property tax or substitute therefor. A uniform state tax on income from intangibles, the revenue from which could be allocated to education, would go a long way toward complying with the mandate of the California Supreme Court, without the necessity of a complete overhaul of the present ad valorem property tax structure.

A tax on investment income would still be preferential to the owners of intangible property in at least two ways:

- (1) Taxing the income from property at a rate, for example of eight to ten per cent, results in far less of a tax than taxing the property itself under the local property tax. Assuming an average assessment ratio of fifty per cent and a 40 mill rate (by including intangibles in the tax base there would be some reduction in the mill rate), \$50,000 worth of stocks would pay a property tax of \$1,000. By taxing only the income at a rate of eight per cent (assuming a five per cent yield on the stocks), the actual tax liability would be only \$200. Moreover, the eight to ten per cent rate is far more favorable to

this type of income as compared to the impact of the present property tax structure on low-middle income families.

- (2) A second advantage to most investment income recipients is that a state investment income tax would be deductible on their federal income tax returns, thereby permitting some real "revenue sharing". Since most of this income is earned by higher income taxpayers who normally itemize their federal deductions (in lieu of taking the standard deduction), the net tax cost of an eight per cent state tax to a fifty per cent federal bracket taxpayer would be only four per cent, with the remaining four per cent in effect being a federal grant to the state or local government collecting the investment income tax.

It is essential to reiterate that a general state income tax on all income does nothing, by itself, to equalize the erosion in the property tax base caused by the nontaxability of intangibles. Most of the states that now tax intangibles (albeit halfheartedly) also have a general income tax. Therefore, imposition of a tax on intangibles, measured by the income therefrom rather than on the value of the property itself, should no more be construed as a double income tax on intangible property than would a sales tax, excise tax, or real property tax, all of which are in reality taxes payable out of a taxpayer's income.

The starting point for measuring the revenue that may be anticipated from a tax on investment income is the United States Treasury Department published data on Statistics of Income for Individuals, Trusts and Estates. Analysis of the 1968 report for individuals and the 1965 report (latest available) for trusts and estates gives us the following breakdown of investment income:

Individuals

Dividend income (before exclusion)	\$ 16.3 billion
Taxable interest	16.7 "
Capital gain (net, before fifty per cent long-term gain deduction)	36.0 "
Rent and royalty income	3.5 "
	\$ 72.5 "
Projected forward from 1968 to 1972 (estimated increase at ten per cent per year)	\$101.5 "

Trusts and Estates

Dividend income	\$ 3.1 "
Taxable interest	.8 "
Capital gain (net, before fifty per cent long-term gain deduction)	2.8 "
	\$ 6.7 "
Projected forward from 1965 to 1972 (estimated increase at ten per cent per year)	\$ 11.4 "
Total Investment Income - Per Treasury Data	\$112.9 "
Add: Unrealized Appreciation of Corporate Stocks (at time of death only)	12.0 "
Total Investment Income Subject to Tax	\$124.9 "

Assuming a rate of eight per cent, the estimated annual revenue yield from this tax would be about \$10 billion. A rate of ten percent would produce about \$12 billion.

In order to make up for the substantial loss of revenue caused by the elimination of intangible property from the property tax base in this country, and in order to ease the tax burden on real property, it is recommended that an eight to ten per cent tax on investment income be imposed at the state levels for the benefit of local government functions. Between \$8-\$10 billion in estimated additional revenue from this source could bolster the property tax structure and permit states to reduce the current property tax rates by an overall average of around thirty per cent."

There are nine states which have attempted to reach intangibles through a special income tax on the annual yield of such property. Ohio has had the most relative success with this method by taxing investment income from intangible property at a five-percent rate, separate from and in addition to its regular income tax on all income, Ohio Rev. Code Ann., Title 57, sec. 5707.04.

According to the Ohio State Tax Commission, \$117 million was collected from the five percent tax on intangible property in 1970, representing three percent of the total revenue of the state. However, even Ohio exempts certain stocks and interest-bearing obligations from this tax. Michigan imposes a three and one-half percent tax on certain investment income, Mich. Stats. Ann., Title 7, sec. 7.556 (1); New Hampshire taxes interest and dividend income at a rate of four and one-quarter percent, N.H. Rev. Stat. Ann., Ch. 77, sec. 77:1; Tennessee taxes the same type of income at four to six percent at the state level, Tenn. Code Ann., Ch. 26, sections 67-2601-2635. Two states, Colorado and Massachusetts, have attempted to rectify the exclusion of intangible property from their local property tax base by establishing a dual-rate general income tax structure, with Colorado imposing a two percent surtax on gross income from intangibles, Col. Rev. Stats. 1963 Ann., Ch. 133-1-2 (2) exempting the first \$5,000 of investment income. The Colorado Department of Revenue reported in 1970 that \$1.8 million was collected from this tax; however, this represents only about one-tenth of one percent of the total investment income in Colorado. Massachusetts imposes a nine percent tax on investment income, including capital gains derived from intangible property, Mass. Gen. Laws Ann., Ch. 62.

SUBCOMMITTEE DELIBERATIONS

At the subcommittee's second meeting following submission of the staff report and an oral presentation by Senator P. J. Gilfeather favoring a tax on the income from intangible property, Senator Broeder moved that moneys and solvent credits be exempt from the property tax laws. Representative Watt moved to amend the motion to the effect that the staff be requested to prepare a bill which would, in addition to repealing the tax on moneys and solvent credits, place a surtax on the income produced by certain intangible property.

At the September meeting the subcommittee further discussed such a bill and requested that the bill provide for returning the tax to the counties in lieu of property taxation; or, if that is not possible, to credit it to the foundation program. The subcommittee also suggested including corporations as well as "natural persons" in the solvent credit tax law.

The subcommittee planned to review the proposed bill or bills at an additional meeting to be held in December. However, at its October 4 meeting the Legislative Council declined to approve an additional meeting of the subcommittee so no final recommendations were made nor were any bills proposed.

INDUSTRIAL FACILITIES TAXATION

Present System

In 1961 the legislature created the new industrial property classification for purposes of property taxation. This classification is set forth in section 84-301, class seven, which reads as follows:

Class Seven. (a) All new industrial property. New industrial property shall mean any new industrial plant, including land, buildings, machinery and fixtures which, in the determination of the state Department of Revenue, is used by a new industry during the first three (3) years of operation not having been assessed prior to July 1, 1961, within the state of Montana. New industry shall mean any person, corporation, firm, partnership, association, or other group which establishes a new plant or plants in this state for the operation of a new industrial endeavor, as distinguished from a mere expansion, reorganization, or merger of an existing industry or industries. Provided, however, that new industrial property shall be limited to industries that manufacture, mill, mine, produce, process or fabricate materials, or do similar work in which capital and labor are employed and in which materials unserviceable in their natural state are extracted, processed or made fit for use or are substantially altered or treated so as to create commercial products or materials; and in no event shall the term new industrial property be included to mean property used by retail or wholesale merchants, commercial services of any type, agriculture, trades or professions. And provided further, that new industrial property shall not be included to mean property which is used or employed in any industrial plant which has been in operation in this state for three (3) years or longer. Any person, corporation, firm, partnership, association or other group seeking to qualify its property for inclusion in this class shall make application to the state department of revenue in such manner and form as may be required by said department.

For three years class seven properties are assessed at 7% of their full value rather than at 30%, resulting in a substantial tax savings.

In adopting the law the legislature stated that its purpose was to:

"encourage and stimulate the establishment of new industry within Montana. The legislature recognizes that a new industrial plant does not reach full productivity and competitive capacity during the initial years of its operation. Since taxation of property should be related to property in proportion to its use, productivity, utility, and

general setting in the economic organization of society, the purpose of this act is to provide a separate classification for new industrial property which gives proper recognition to these factors and places such property in the proper class for taxation purposes."

The Department of Revenue interpreted this purpose clause to be twofold:

- (1) to encourage persons and business units outside the state of Montana to establish new industrial plants within the state, and
- (2) to encourage the creation of new industries from within the state by Montana citizens and business units.

Under the present law "new industry" does not include:

- (1) industrial endeavor which constitutes "expansion, reorganization, or merger or an existing industry or industries";
- (2) industrial endeavor which does not consist of industries which:
 - (a) manufacture, mill, mine, produce, or fabricate materials, or
 - (b) extract, process, make fit for use, or substantially alter or treat materials so as to create commercial products or materials;
- (3) the service industries, where the processing or handling of materials is only incidental, and specified as retail or wholesale merchants, commercial services, agriculture, trades or professions.

In other words the legislature has expressly limited "new industries" to those which in some manner take raw materials and by some process produce a usable or commercial product, excluding agricultural activities. The practical result has been that almost all of the companies applying for class seven status are large companies with well-established markets for their products (such as coal and lumber), whereas service-oriented companies and many other environmentally neutral industries do not qualify for class seven status.

Since passage of the new industry classification law in 1961 there have been approximately 66 applications; 20 have been denied class seven designation. The following is a list of the applicants since 1967 who have successfully obtained the new industry tax break. In the past three years Mr. Batchelder, a pig farmer, was the only applicant that was not a large company with a preestablished market.

NEW INDUSTRY CLASSIFICATION

1967-1975

Richard Batchelder	1974
Berklund Lumber Co.	1967
Bonanza Packing Co.	1970
Borden, Inc. (Missoula)	1971
CB&F Development Corp.	1967
Champion Plywood	1974
Clark Canyon Lumber Co., Inc.	1969
Evans Products Co.	1971, 1972, 1973
Idaho Cibola Mines, Inc. (Libby)	1971
Jumping Rainbow Trout Products	1973
Kelly Feeds, Inc.	1972
McCulloch Oil Corp.	1970
Mineral Engineering Co.	1967
Montana Farms	1973
Morrison-Knudsen	1975
Mountain Manufacturing Co., Inc.	1967
William L. Murnion	1971, 1972, 1973
Northern Timber Co., Inc.	1967
Peabody Coal Co.	1971, 1972
Pintlar Forest Products, Inc.	1967
Polson Wood Products, Inc.	1968
Valley Machine & Engineering	1971
Mr. Allan Wang (Baker)	1969
Westmoreland Resources	1975

The Department of Revenue has published regulations and a policy statement concerning new industrial properties classification. The regulations detail the department's definition of new industry under the law and explains the reasoning behind policy decisions made by the department when considering applications for class seven classification. At the July 1 meeting of the subcommittee, Department of Revenue personnel stated that in their opinion the law should be clarified or changed so that the new industry class is given only to those industries which do not have an established market for their products.

ADDITIONAL STUDIES

During the summer of 1974 the Department of Intergovernmental Relations and the Montana Chamber of Commerce were engaged in a

task force study effort relating to Montana's economic development. The Taxation Subcommittee decided to delay any decisions or recommendations until the results of the task force study were made available, possibly in early September. The subcommittee did suggest that the council staff initially draft a bill which would suggest various alternatives to the present industrial facilities tax and which would specifically develop two points:

- (1) Those industries, particularly the large ones, who would locate in Montana because of the natural resources, and regardless of the tax structure, should be removed from eligibility for the favorable tax classification.
- (2) The benefits of this classification should be extended to smaller, service-oriented businesses and perhaps be especially extended to Montana-owned businesses.

At the July meeting a delegate from the Montana Chamber of Commerce gave a statement relating to economic development and tax incentives. The Chamber's position regarding the new industrial facilities tax break was as follows:

"We believe the provision providing for a 3-year tax abatement on new industrial facilities fails to accomplish any positive purpose as presently drawn and interpreted. It should be noted that this tax advantage is only available to new companies locating in Montana and does not apply to expansion or new facilities at a new location engaging in an entirely unique kind of manufacturing if the parent company operates in Montana. The facts of economic development are that most new jobs are produced by expansions of existing industry. Secondly, we question whether there is any logic or reason to discriminate between employment opportunities resulting from expansions or new activities by companies already in the state as opposed to a new, untried, unknown company entering the state. The provision is probably most deficient in the ridiculous limitation which provides "unusable in their natural state". By interpretation, this makes the provision applicable only to natural resource or initial agricultural processing plants. It specifically excludes from benefits of the law the kinds of clean, technological and processing industries which provide high-quality employment opportunity or which would permit us to further process our agricultural and natural resources."

At the September meeting the subcommittee considered summaries of the Montana Economic Development Task Force studies in each of five major economic activities in Montana: agriculture, forest products, manufacturing, mining, and tourism.

Major recommendations relating to subcommittee deliberations were made by the Committees on Manufacturing and Agriculture.

The Committee on Manufacturing recommended:

- (1) Extending eligibility for class seven to all manufacturing and processing industries that utilize materials that are serviceable in their natural state as well as those materials that are not serviceable in their natural state.
- (2) Requiring that an industry seeking such classification negotiate the terms of the classification with the responsible local government within which the new property is to be located. The recommendation of the local government would be referred to the Department of Revenue.
- (3) Allowing the municipality to recommend the classification for up to five years contingent upon the degree to which the industry meets the requirements of guidelines that may be established.
- (4) Allowing a corporate tax credit of one percent of gross expenditures for wages and salaries to new industries for up to five years.
- (5) Giving local governments authority to levy up to one mill for economic development within their jurisdiction.

The Committee on Agriculture recommended:

- (1) that incentives be provided to promote the further development of new irrigation systems, such as relief from the present increased tax rate imposed on irrigated agricultural lands as compared to the tax imposed on nonirrigated farm or rangelands;
- (2) that any land where new pumping or sprinkler irrigation systems are installed by the landowner not be taxed at an increased rate initially but rather retain the taxable value imposed previous to the installation of the irrigation system for a period to be specified by legislation;
- (3) that the installation of all new pumping and sprinkler irrigation systems developed to irrigate present nonirrigated land not feasible to be irrigated by gravity, receive a property tax incentive by inclusion in class seven of the property classification laws (84-301).

SUBCOMMITTEE DELIBERATIONS

At the September meeting the subcommittee determined to further study the Chamber of Commerce recommendations which were to be finalized in October and to consider such recommendations at an additional meeting to be held in December. However, the Legislative Council, at its October 4 meeting, declined to approve the subcommittee's request for an additional meeting so no final recommendations were made.

